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CUNA Oral Comments - NCUA Budget Briefing

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Good morning. I'm Credit Union National Association's Chief Economist Mike Schenk – and I appreciate the opportunity to share some observations on the NCUA budget process, the budget itself and the agency's strategic direction implicit in the proposed budget. As you know, the Credit Union National Association or CUNA is the largest trade association in the United States serving America's credit unions and the only national association representing the entire credit union movement. CUNA represents nearly 5,500 federal and state credit unions and their approximate 115 million members.

CUNA's interactions with NCUA have improved over the past several years. The agency has been especially responsive to CUNA's calls for more information and rationalization of the budget and agency expenditures.

In fact, the NCUA – in its long history – has never been more transparent in communicating and explaining budget priorities and initiatives; and has never been more transparent and thorough in connecting the budget to a well-thought-out, detailed strategic plan – formulated with industry input.

In addition, having spent many hours each year over the past several years reviewing materials produced by other depository institution regulators I can say with some authority that those produced by the NCUA set the standard for what might reasonably be viewed as budget process "best practices."

A lot has happened over the past several years – and NCUA has listened to and has been generally responsive to CUNA and credit union concerns.

For example, several years ago, CUNA expressed concern about the NCUA's Overhead Transfer Rate calculation and in November of 2017, the Board approved adjustments that demystified the OTR calculation process resulting in a fair, simplified, principles-based methodology.

CUNA also objected to fast-rising rising costs and overstaffing and urged the NCUA to more aggressively look for efficiencies. The NCUA responded. In January of this year, NCUA consolidated its five regional offices into three. The NCUA reorganized and streamlined the Office of Small Credit Union Initiatives & other functions into the Office of Credit Union Resources and Expansion.

In addition, the NCUA now is well on its way to using an extended examination cycle for many well-managed, low-risk federal credit unions and it performs streamlined examinations for well-managed small credit unions.

We applaud those actions.

CUNA has examined the Budget Justification document and once again, find it to be clear, comprehensive, and well-developed. The proposed activities and expenditures described align with previously-announced and vetted strategic initiatives including the Examination Flexibility Initiative, remote examinations & data analytics, as well as modernization of the agency's Information Technology systems and cybersecurity concerns.

The NCUA's Proposed 2020-21 Budget reflects a 3.9% increase, which seems reasonable in the context of approximately 2% inflation and with the 6% increase in credit union operating expenses which is the point of reference for most credit union CEOs.

CUNA fully understands and appreciates how personnel costs have a dramatic effect on overall agency expenditures and recognizes that regulatory and contractual obligations drive a substantial portion of the changes in overall agency budgeted expenditures each year. In this regard, CUNA appreciates the NCUA's focus on holding head-count in check. And we look forward to seeing more obvious evidence of the savings that remote and extended examinations might have on overall costs.

This is all vitally important: Credit union operations have generally benefited from the economic expansion and bottom-line results are at cyclical highs. Yet fully two-thirds of respondents to CUNA's most recent Examination Survey say that heavier regulatory/examination requirements are putting increasing pressure on credit union resources. And that makes effectively serving members a more difficult challenge.

I'd like to take this opportunity to briefly review some of the themes CUNA is hearing from member credit unions. We've specifically engaged members of our Advocacy Committee and our Examination and Supervision Subcommittee on this issue and my comments reflect their views.

Regional Consolidation

First, while we applaud the NCUA for its focus on cost savings and efficiency in consolidating regions, we encourage the agency to focus on smooth transitions with as little disruption, philosophical disconnect, and course correction as possible.

In particular, we urge the agency to be mindful of results of the 2018 CUNA Examination Survey which reflected great concern about regional consolidation. Overall, 35% of respondents indicated they believed new examination teams would have an "extremely negative" (12%) or a "modestly negative" (23%) impact on their examination experience.

Inconsistency in the interpretation and application of rules and regulations are especially challenging for credit unions that have new examiners. These inconsistencies can throw strategic plans off track resulting in significant service disruption and misallocation of resources.

Indeed, the top examiner/exam team issue in our Exam Survey was examiner willingness to account for credit union business plans when discussing exceptions. This issue received an average rating of only 3.9 on a 5-point scale. In addition, only 70% of survey respondents agreed that examiner/exam teams are flexible and open to discussion and exchange of perspectives with credit union staff. Over half (51%) agreed that examiners apply "guidance" as if it was enforceable regulation and nearly half (46%) agreed that examiners applied "best business practices" as a regulatory standard.

These are overall results and are not specific to the effects of regional consolidation – but they do underline the special need for increased emphasis, communication, and consistency during the transitions related to realignment.

Examination Cycle

The Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) was designed to soften the pendulum blow which was the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 for community financial institutions, and CUNA strongly supported the legislation.

Included in Section 210 of the law is a provision that amended the Federal Deposit Insurance Act to increase the asset limit below which depository banks are eligible for an 18-month examination cycle (rather than a 12-month examination cycle) from $1 billion in assets to $3 billion in assets.

In December 2018, the federal banking agencies issued a final rule to implement this provision, giving banks holding under $3 billion in assets an examination only once every 18 months, leaving credit unions on an uneven playing field.

Credit unions, however, remain eligible for an 18-month examination cycle only if their asset level is below $1 billion. This regulatory disparity now serves as a comparative advantage for community banks.

Congress has already delegated authority to NCUA to set the frequency of examinations for credit unions. Credit unions deserve the privilege of providing customer service subject to comparable regulatory supervisory thresholds as applied to banking organizations – and this issue continues to be a concern among industry leadership: We urge the NCUA to extend the credit union asset threshold from $1 billion to $3 billion.

NCUSIF Normal Operating Level

In December 2018, the NCUA Board approved a reduction of the Share Insurance Fund Normal Operating Level from 1.39% to 1.38% for 2019.

CUNA thanks NCUA for acting to lower the Normal Operating Level. And, we strongly support and encourage the NCUA to issue additional share insurance fund distributions whenever possible with the expectation that the initial increase in the Normal Operating Level was temporary.

We're encouraged that NCUA is honoring its commitment to review the Normal Operating Level each year and we look forward to the possibility of any additional distributions depending on NCUA's analysis. While the NCUA believes an increase in the Normal Operating Level was necessary while the Share Insurance Fund holds corporate legacy assets, we look forward to a phase-down of the NOL to 1.30% by 2021.

In the interest of transparency, CUNA welcomes the NCUA's views on the possible return of capital from conserved corporate credit unions, including more information and discussion on the mechanics and considerations surrounding the decisions to sell or manage securities of the various estates after the NCUA Guaranteed Notes are retired.

Expanded Office of Consumer Financial Protection

Board Member Harper, as a supplement to the official budgetary process, has proposed the expansion of the agency's Office of Consumer Financial Protection with the goal of creating a dedicated consumer compliance examination program for "large, complex credit unions." While this proposal may be well-intentioned, CUNA and our members believe altering the agency's risk-focused examination process and substantially increasing examination-related expenditures is not warranted.

There has been no supplementary evidence introduced or observed to suggest credit unions' consumer compliance management has become a risk area warranting an increased expenditure of agency resources. Absent evidence demonstrating an emerging need or establishing a clear benefit to all credit unions, our members view the proposal as a solution in search of a problem.

As its mission statement makes clear, the NCUA exists to ensure the safety and soundness of the credit union system and its examination program should remain focused on that objective. In addition, the agency already has the tools in place to further evaluate a credit union's consumer compliance program when a need is identified through the risk-focused examination process. In fact, the current safety and soundness examination procedures include an evaluation of a credit union's consumer compliance risk – which is subsequently incorporated into a credit union's CAMELS rating.

We also caution the NCUA against drawing parallels between itself and bank regulators in terms of resource allocation or examination priorities. Ultimately, each federal banking agency is tasked with overseeing significantly different entities with markedly different organizational structures, product offerings, and risk profiles. The fact that a regulator of for-profit banks identifies a systemic need for the industry it regulates does not necessarily mean that other regulators – especially the regulator of not-for-profit cooperatives – ought to follow suit.

Credit unions' unique structure embodied in member-ownership and democratic-control ensures that the incentives faced by management are aligned with and are in the best interests of consumers. At credit unions, the absence of outside investors demanding a market rate of return on investment ensures pro-consumer behaviors and strongly discourages abuses. Furthermore, CUNA's recent study of financial institution executive compensation reveals that, adjusted for asset size, bank Chief Executive Officers receive a substantially higher proportion of their overall pay in so-called "high-powered" compensation – pay-for-performance schemes that encourage excessive risk-taking and a wide variety of anti-consumer behaviors.

The NCUA, we believe, would be wise not to concede ground to the bank regulators as somehow "doing it better." If that notion were true, then bank fines and lawsuits due to violations of consumer protection laws would not be as commonplace as they are currently. According to Barclays and Capital Performance Group, the largest domestic and European banks operating in the United States have incurred nearly $300 billion in fines since 2009.

Rather than developing and implementing a new, costly examination procedure, CUNA recommends the NCUA build upon the consumer compliance resources currently available to credit unions through the agency, and further improve examiner training to ensure examinations are more efficient and less invasive.

There are several other issues that we'll discuss in some detail in our written comments. However, in closing, I would like to reiterate CUNA's belief that seeking and considering industry feedback prior to proposing regulations, adopting strategic initiatives, and producing detailed budgets helps to ensure that those activities are better understood by all stakeholders. Ultimately, this means that they will be more effective.

The NCUA Board – in its approach to the budget process – recognizes and embraces that idea and we encourage continued dialogue and focus on efficiencies and cost savings that allow credit unions to do what they do best: effectively serve and improve the financial health of millions of Americans.

On behalf of CUNA, thank you for the opportunity to speak to you today. I'd be happy to address any questions you may have.